



## Why Penn West Petroleum Ltd.'s Financial Position Remains Precarious

### Description

It has been a tough year for investors in beleaguered upstream oil producer **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE). After being rocked by an accounting scandal, operational issues, and the possibility of breaching its financial covenants, along with the sharply weaker oil prices, it is easy to understand why it has lost the market's confidence. As a result, its shares plunged by a massive 71% in that period, with the market virtually pricing it for failure.

Surprisingly, even after all this bad news some analysts are convinced that Penn West offers a levered bet on a rebound in crude prices. This couldn't be further from the truth as it is still under considerable pressure from sharply weaker industry fundamentals.

### Now what?

Recent first-quarter 2015 results certainly highlight Penn West's plight. It missed the consensus analyst estimate by posting a net loss of \$0.49 per share, more than double that expected. This was also almost triple the net loss posted for the same quarter in 2014. Funds flow also fell by over half year over year to \$0.22 per share and this is extremely concerning given the capital-intensive nature of the upstream oil industry.

These poor financial results can be primarily attributed to sharply weaker oil and natural gas prices, along with lower production volumes because of recent asset dispositions.

Penn West also continued with its asset disposition program and recently sold 8.5% of its royalty rights for a range of properties in Saskatchewan, Alberta, and Manitoba for \$321 million. These proceeds will be used to reduce its onerous mountain of debt and will amount to almost 50% of the \$650 million in asset dispositions committed for 2015.

Penn West has also been able to renegotiate its financial covenants, with its lenders agreeing to relax them for a temporary period that expires at the end of 2016. This is in the hope that oil and gas prices will rebound significantly before then, allowing it to generate stronger cash flow and EBITDA, while having further reduced its debt.

Despite that Penn West has demonstrated some success in executing this turnaround strategy, I don't believe the outlook is as positive as some analysts claim.

You see, by continuing to dispose of oil assets, oil and gas production can only continue to fall, which will negatively affect revenue and cash flow. This is certainly not an attractive attribute in a harsh operating environment dominated by weak commodity prices. It also doesn't bode well for Penn West's ability to quickly ramp up production when crude prices rebound.

Furthermore, by relaxing its financial covenants for a temporary period, it is essentially kicking the risk of breaching those covenants might create financial distress further down the road. While it has done this in the hope that crude prices will rebound before that period expires, it has only delayed the inevitable should oil prices remain weak for a sustained period.

### **So what?**

Penn West certainly offers some upside, particularly when the quality and value of its oil assets are considered, although the risk far outweighs the reward. There are far too many risks associated with its financial position. Because of the uncertain outlook for crude and diminishing production volumes, there is the potential for Penn West's financial position to deteriorate even further.

### **CATEGORY**

1. Energy Stocks
2. Investing

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1. Editor's Choice

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